

Employer Responsibility for Limit Testing on Tax-Deferred Plans

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All tax-deferred retirement plans are subject to limits on the amount of compensation that can be deferred or otherwise contributed by or on behalf of a participant. When an employer offers multiple defined contribution plans or vehicles for retirement savings to its employees, care must be taken to coordinate the various applicable limits.

In the past, some employers have offered supplemental defined contribution plans, including 457 plans, 403(b) plans, or 401(k) plans. These plans were offered in addition to the PERSI defined benefit plan (now called the PERSI Base Plan). However, many employers offered no supplemental plan, which meant that many public employees had no means for increasing their retirement savings on a tax-deferred basis.

PERSI Choice Plan

The legislature decided that the excess earnings in the PERSI fund provided an opportunity to provide every PERSI participant with a supplemental retirement plan that they could control and to which they could make contributions. As a result, every PERSI member has, or will soon have, their own PERSI Choice Plan account. A Choice Plan account consists of a 401(k) account for voluntary contributions (and direct employer

contributions as determined by the employer, if any) and a gain sharing account. Allocations made to a member's gain sharing account generally are considered employer contributions to a defined contribution plan for limit testing purposes.

If an employer offers no supplemental plans other than the PERSI Choice Plan, all limit testing is done by PERSI (or its record keeper). However, if an employer offers any other supplemental plan, the employer will have an obligation to coordinate limit testing of all plans because PERSI does not receive the necessary information about contributions made to other plans. Only the member and the employer know where the member has elected to make deferrals, and how much.

Because gain sharing allocations made in February of this year relate to the 2000 limitation year, some employers need to ensure that their employees did not exceed applicable limits due to gain sharing. The general effect of gain sharing on various plans is described below. Employers who offer these supplemental plans should take appropriate action.

How gain sharing affects 401(k) plans

Gain sharing may affect your 401(k) plans. Your 401(k) plan is

subject to two separate limits – one limiting elective deferrals (elective deferral limit) and one limiting total contributions, including both elective deferrals and employer contributions (annual additions limit). Gain sharing will not affect the elective deferral limit but it is included in determining whether a participant has exceeded their annual additions limit. Whether gain sharing will affect the annual additions limit will depend on the level of the participant's compensation, the amount of elective deferrals and employer contributions to the 401(k) account, and the level of gain sharing each year.

How gain sharing affects 457 plans

It won't. Employer contributions to a qualified defined contribution account are not considered when applying 457 limits. Gain sharing is a contribution to a qualified defined contribution account and is considered an employer contribution for purposes of limits testing. However, keep in mind that elective deferrals into either a 401(k) or 403(b) account will affect a 457 plan.

How gain sharing affects 403(b) plans

Depends on what elections have been made, if any. 403(b) plans are

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Limits testing

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generally subject to the lesser of three different limits – an elective deferral limit, an annual additions limit, and a maximum exclusion allowance (MEA). However, employees of certain qualified employers (such as school districts, hospitals, etc.) may irrevocably elect one of three alternative limits provided by section 415(c)(4)(A), (B) and (C) of the Internal Revenue Code. One of those alternatives, commonly known as the “C” election (corresponding to subsection (C) of section 415(c)(4)) or the “overall limit”, permits the 403(b) participant to disregard the MEA. However, in exchange for disregarding the MEA, the participant must include all employer contributions to all qualified plans together with all 403(b) contributions when applying the annual additions test.

This means that gain sharing will be included in the 403(b) annual additions test only when a “C” election is effective.

What should employers be doing if they offer a 401(k) plan or a 403(b) plan?

You should have acquired gain sharing amounts from PERSI for all 401(k) participants, and for any 403(b) participants who have “elected” the “overall limit” (or “C” election). These amounts need to be included in year 2000 annual additions limit testing for each plan, and if necessary, excess contributions should be refunded to the participant from the elective deferrals made to whichever plan(s) exceeded the annual additions limit due to gain sharing. These refunds will be considered taxable income for the year in which they are refunded

and the employer (or plan) should issue a 1099-R related to those refunds.

What should employers do if they have questions about how limits apply?

Limits questions can become complicated, particularly when a member contributes to multiple plans. PERSI encourages members and employers to consult qualified tax professionals to ensure all applicable limits are not exceeded. If you are unable to resolve questions, contact PERSI. Although PERSI can provide limited direction and assistance, the member and employer are ultimately responsible for assuring limits are not exceeded. Failure to comply with limits can result in penalties against both participants and the employer.

Electronic Funds Transfer (EFTs) available soon

PERSI is preparing to implement a new electronic receipts process in which employers can electronically transmit their contributions, rather than mailing us a check. The process is called Electronic Funds Transfer (EFT). EFT transactions will be initiated by the employer dialing in a payment instruction to a toll-free phone number. Your payment would be processed through an automated clearinghouse (ACH) overnight, and reach PERSI the following day.

Some advantages of EFT are:

- Employers would be able to control when payments are sent out of their accounts,
- Employers could better rely on payments reaching PERSI within required timeframes,
- Employers would save the time and costs of creating, mailing and redeeming checks,
- Employers will be able to meet the shorter time frames required to transmit employee voluntary contributions to the new PERSI Choice Plan 401(k) .
- ACH transactions are processed automatically, with minimal bank fees (usually pennies),
- Your account would be set up with a password/PIN number for security and proper authorization,
- PERSI would receive payments without any mail delay or loss.

The State Treasurer's Office already has a similar EFT program in place. If everything works according to schedule, we hope to implement EFT by early summer of this year. As we find out more about EFT transactions, we'll let you know.

If you have any suggestions on this new process, or are interested in being a pilot agency for EFT payments, please call Jim Monroe at 1-800-451-8228 or 334-3365, ext. 231.